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RUEHCV/AMEMBASSY CARACAS 0728
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¶1. (SBU) SUMMARY: On April 23, 2008 Ambassador Sobel, Treasury Attache, Senior Commercial Officer (SCO) and EconOffs met with the Brazilian-arms of the American accounting firms Pricewaterhouse Coopers, Ernst & Young, and KPMG. The themes of the U.S.-Brazil CEO Forum dominated the discussion, including bilateral tax (BTT) and investment (BIT) treaties, infrastructure, education, and competitiveness. The firms were hopeful but not optimistic about the potential to make significant progress in any of these areas in the near-term. END SUMMARY

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Bilateral Tax Treaty
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¶2. (SBU) In recent Mission discussions with Brazilian authorities on a BTT, the overwhelming concern that GOB authorities have voiced has been related to information exchange and bank secrecy laws (Refs A, B, C). Discussion with the firms, however, concentrated on tax-sparing, tax assignment and transfer pricing as the major hurdles ahead. On transfer pricing (the method chosen to price inter-company transactions) Pricewaterhouse Coopers (PwC) highlighted that Brazilian transfer pricing rules - which impose arbitrary presumed profit margins - do not correspond to actual market practices and OECD (and U.S.) transfer-pricing principles. (Note: Germany suspended its BTT with Brazil in part due to Brazil's transfer pricing practices. End note.)
¶3. (SBU) With regards to tax-sparing (provision whereby a contracting state agrees to provide a credit in the home country against foreign income that has not actually been collected), PwC was of the opinion that the GOB should not get hung-up over this issue, as the internal withholding tax rates in Brazil are generally the same as the rates approved in most all treaties signed by Brazil (and U.S. treaties allow for some flexibility in terms of withholding rates). PwC also downplayed the GOB's concerns regarding state tax disparities between the North/Northeast and the rest of the country. Currently, the foreign tax credits available to the subsidiaries of U.S. companies in those regions are at a rate lower than the nominal tax rate in the U.S. In PwC's analysis, the

treaty would not change in any respect the existing tax results in either country.

¶4. (SBU) In a recent study PwC did on the BTT for the Brazilian side of the CEO Forum (and shared with the GOB), they concluded that the BTT would benefit Brazilian investors "assuming that the treaty would limit withholding income tax to a maximum of 15 percent" (compared to the standard 30 percent levied under U.S. domestic law for payments of non-U.S. persons of dividends and royalties). They also predicted "no significant reduction for Brazilian tax collection," highlighting that mid-sized U.S. companies would feel more legal security investing in Brazil. Their analysis underscores the potential for expanded employment opportunities derived from increased U.S. investment.

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Bilateral Investment Treaty
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¶5. (SBU) On prospects for a BIT, the Ambassador noted that divergences on arbitration have been the biggest impediment in moving forward. PwC was of the opinion that in the short-term it would be difficult to make progress on this issue, as it is one that has to do with mindset and political sensitivities. At the same time, the firms noted that this approach is bound to change over time as Brazilian companies invest abroad with greater intensity. Increasingly, the GOB will see international arbitration as being in its best interest. For instance, PwC recalled that Petrobras was considering international arbitration during the 2006 nationalization crisis with Bolivia.



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Infrastructure
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¶6. (SBU) PwC was of the opinion that the GOB and state governments need to look beyond Public-Private Partnerships (PPP's) to "more sophisticated investment models" for attracting private investment. (NOTE: PwC did not offer specific examples of what these more sophisticated models are. END NOTE) PwC also raised the point that privatization of infrastructure projects (roads, ports, airports) carries the additional factor of falling under national security considerations. Other factors weighing on investor calculations include the lack of transparency of regulations and licensing requirements, and a legal framework that makes corporate managers personally liable for certain environmental and workplace violations. Moreover, the performance bonds associated with Brazilian infrastructure projects are sometimes backed by banks that are not held in high repute by international investors. (COMMENT: This assessment of the GOB's rocky start with PPP's is consistent with what the Commercial Service is hearing from U.S. companies concerning their experiences to date with infrastructure projects. END COMMENT.)

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Competitiveness and Tax Reform
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¶7. (SBU) There was extended discussion on Brazil's domestic tax regime and competitiveness. Brazil's standing among the most burdensome tax systems in the world has real consequences for Brazil's competitiveness globally. All highlighted the ICMS tax (rough VAT-equivalent collected at the state level) as being particularly frustrating. ICMS rates and tax benefits vary from state to state, and have a history of sparking tax disputes between states and hindering the operations of foreign companies (Ref D). All the firms were of the opinion that the tax reform proposal that the Lula government submitted to Congress in early March is a good one, but that it is unlikely to be approved due to lack of political ownership and the fact it will create revenue loss among some state governments who will oppose the measures. As the decision to change ICMS rules would also require a constitutional change, the chances of this happening are slim. Nevertheless, the firms voiced support for the GOB proposal to standardize the ICMS/VAT and compensate the

states for the lost revenue by transferring other taxes back to the states. (Note: This will be the second tax reform proposed during Lula's presidency and aims to simplify the current tax code rather than reduce the tax burden. The 2003 proposal failed to make meaningful reforms due to similar opposition from state governments. End Note.)

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October 2008 CEO Forum Planning
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¶8. (SBU) The firms had several suggestions for themes to be included on the October 2008 CEO Forum agenda: 1) education, highlighting that education is at the heart of competiveness; 2) environmental issues including carbon credits and climate change; 3) biofuels and energy policy; and 4) financial market trends, including Brazil's growing rate insurance market (insurance against changes in exchange rates, performance bonds, interest rates, etc.). In addition, the Ambassador agreed to consider whether to recommend to the members of the CEO Forum that they include a meeting with the Big 4 accounting firms on their agenda as well.

¶9. (U) This cable has been cleared by Ambassador Sobel and coordinated with the US Treasury Financial Attache in Sao Paulo.